

Everything about the Banking System. Why It Is Important to Know the Bank Owners?

Analytical Commentary

Author: Dumitru Pintea

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The Moldovan Banking Sector - as Big, as Vulnerable...

Everyone, at some point, needs a bank, whether for a loan, for a deposit, a salary account or a counter payment. Nonetheless, not all of us understand how a bank works and what is its role in the financial system. Mainly its basic functions confirm the crucial role of banks in a modern society, these being the institutions that mobilise the available money and finance private affairs or public expenditures. Besides this, technological development complements the role of banks with another important function, which is payment system and money transfer – operations that we all perform almost every day.

The collapse of the Soviet Union and the transition to a new economic model based on individual entrepreneurship and private initiative created the premises for the emergence and development of commercial banks in our country. After more than 25 years, the banking sector has become the main pillar of the national financial market, accounting for about **90%** of the market's assets, or **MDL 75 billion**. The size and importance of the sector is also reflected by its share in the national economy, with bank assets accounting for more than **55% of GDP**. Besides this, commercial banks are also the largest funder of the Moldovan economy with credits amounting to approximately **MDL 34 billion**, much above the capacities of other institutions in the field, such as microfinance or leasing companies, which cumulate funding of about **MDL 5.5 billion**.

However, the Moldovan banking sector was not invulnerable, since 90s its development and potential were affected by a number of systemic problems. From faulty management and poor transparency of shareholders to suspiciously granted non-performing loans, money laundering and significant fraud – these being the most important elements that brought it to the brink of collapse in the autumn of 2014. The investigation results show that this mix of elements was permanently supported by the scourge of corruption, which affected the activity of some bank managers in tandem with that of high-ranking state officials and politically exposed persons.

Why Isn't the Domestic Banking Sector a Success Story?

Although, theoretically, it is the so-called foreign investors that predominate, a big share of the banking sector capital is actually owned by Moldovans who have dissimulated their identity through offshore jurisdictions. Although the share of foreign investments reaches **81%** of the bank share capital, the European financial groups have a market share of only **25%** according to the value of the assets. This lack of clarity

and transparency in shareholding was one of the key elements that caused the deterioration of the financial situation of several banks. The cause of this situation is neither new, nor random, since the country's largest financial resources and the most important financial flows are performed through commercial banks.

Profitable, sometimes poorly supervised and safe from the point of view of the money invested, the Moldovan banking sector has always attracted the interest groups and rich people, their main objective being... to make even more money. It was this increased interest that generated a fierce struggle for bank shares, those securities that eventually determine the ownership and voting shares in a bank. The struggle was carried on several fronts and over several years, regardless of the ruling regimes and parties. The aim was the same – to control the banks and the financial resources of the population, by means of state institutions or suspicious private transactions. It reached its peak at the end of 2014, when the Moldovan banking system underwent a systemic crisis. The scale of its results puzzled even the international community. Major frauds, the collapse and liquidation of three banks, high-level corruption and, above all, the colossal amount of public money necessary to stabilize the situation, are the harshest conclusions of this sad episode in the history of the country.

Do we know each other well enough?

Although the international financial crisis initially appeared to have affected the Republic of Moldova, the results and subsequent events clearly demonstrate that the main reasons and triggering factors were mostly internal. One of these factors, which is not completely eliminated until today, is the **low transparency of banks shareholders** and of their way of doing business. Practically, when the shares of some banks could not be obtained legally, some illicit means were used, like the notorious *raider attacks* after 2009. Nonetheless, given that the new shareholders became owners in an illegal and fraudulent way, revealing their true identity became a problem. The solution was easily found, with shares being massively registered on the name of fictitious people or transmitted to offshore companies.

History shows that people who cannot prove the legal origin of some financial means will never want to associate their names with the goods they own. Tax dodgers, drug traffickers, terrorists or corrupt politicians are among the widest categories of people trying to conceal their identity and, what is more important, it is extremely difficult – sometimes even impossible for state institutions to find out what a person actually possesses. This demonstrates that it is not enough to know who the shareholder of a bank is, but who is the ultimate beneficiary of the shares, in other words who is the person who ultimately controls the bank and collects the profit.

Are we at risk even if banks are a private business?

Although banking is a private business, banks prove their public character in terms of maintaining financial stability and protecting depositors. Besides, ensuring a stable and attractive financial environment for economic activity is a public good that every citizen has the right to enjoy, although the saving of fraudulent banks with the involvement of taxpayers goes beyond the principles of market economy. Respectively, corruption is not specific only to public institutions, but also to private ones, and the banking crisis has shown that the consequences can be at least as serious, up to the embezzlement of public money.

The change of owners through raider attacks and concealing beneficial owners through intermediaries or offshore firms were obviously done by means of some corruption acts, especially at the level of the judicial system that legislated these transactions. The change of owners has often led to the change of the persons in key positions, loyal persons who promote risky actions in the interest of the real beneficiaries. Under these circumstances, the lack of transparency has led to threats to the stability of these banks, the intention of new owners being to obtain an immediate profit rather than to develop the banks and secure depositors. Moreover, excessive risks have also been passed to clients, especially to the depositors who had entrusted their financial resources for deposit and investment. Lack of transparency of shareholders does not hinder, but rather facilitates the granting of non-performing loans to affiliated persons, which can lead to the deterioration of bank's financial situation, and ultimately to a reduction in the ability to honour its obligations to depositors.

Last but not least, such risks as affiliation and concentration among large banks, breach of credit norms or money laundering, have prepared the ground and caused the massive fraud in a number of banks between 2014-2015. An unclear identity of the shareholders hinders the assessment of a whole set of events, which at some point can trigger the most dangerous actions, namely:

- Impossibility to hold shareholders responsible
- Limit in sharing the loss
- Incapacity to assess the shareholders' quality
- Facilitation of raider attacks
- Promotion of dishonest and poorly managers.

Do you know who you trusted your money with?

In the case of raider attacks and banks fraud, the National Bank of Moldova (NBM) did not have the full capacity to prevent the deterioration of the situation. The political involvement, and that of the judiciary system, along with the phenomenon of corruption, undermined the regulator's power and somehow prepared the ground for the future frauds. In turn, while forced by several court decisions, the banks could not block the access of suspicious persons to their shareholding. Later, a major crisis and significant legislative amendments were needed to block these shareholders.

Considering the systemic importance of commercial banks and their public nature (banks work mainly on the basis of the resources drawn from the population and companies), the banks' customers, the regulator and the entire society have the right to know who the actual owners of banks are. The NBM has the role to supervise the domestic banks, including the quality and transparency of shareholders. The NBM, in cooperation with other state institutions, is responsible for the quality of the ownership structure, for the actions and the involvement of the shareholders in the management process, and for the number of contracted loans by affiliated persons. At the same time, in the event of some transgressions and in order to improve the situation, NBM can apply a series of sanctions and remedial measures, all having the ultimate objective to protect depositors and ensure the stability of the financial system. Besides, NBM must act as a barrier to the admission of suspicious people and people with bad reputation to commercial banks' shares. To this end, the regulator has to implement and apply the international standards in terms of skills and

reputation for bank shareholders (fit-and-proper test), as well as to evaluate periodically the situation of the existing shareholders.

Banks also have an important role in terms of their ownership structure. They must ensure that the existing shareholders meet the requirements and, in case of some gaps, intervene to eliminate the shortcomings. At the same time, in order to eliminate any suspicion about shareholders and to strengthen the customers' confidence, banks could provide additional information about their shareholders, such as resumes, details of their activities, and/or how they are involved in the banks' business. It is these criteria that could bring about a high degree of transparency of shareholders, and ultimately of the bank's overall ownership structure.

Last but not least, each of us can contribute to the transparency of the shareholding structure of banks. During any transaction with the bank, the customer discloses his/her identity by means of the identity card, and the bank must inform the customer about its shareholders. Legislation supports us, too, and qualifies banks as '*public interest entities*', which implies that they must have a high level of transparency both in relation with the regulator and with customers. The NBM documents clearly regulate the information that customers should have access to. Thus, in addition to the information on the economic and financial situation, banks have the obligation to disclose and present the information on corporate governance, namely who manages the bank and in whose interest.

The Internet provides a fast way to view the owners of commercial banks on official websites. Just two clicks away, under '*Information Disclosure*' Section, we can view the information about shareholders and beneficial owners of any bank. This information has a public nature, therefore, traditionally, we can also get it at banks' subsidiaries. Thus, when choosing a bank as a business partner or institution to keep our savings, it is important to know whom we entrust with our money and who is the real owner of the bank. Then, everybody can decide whether to trust the bank or not.